

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)	
COMMISSION OF THE ENVIRONMENTAL)	
SURCHARGE MECHANISM OF LOUISVILLE GAS)	CASE NO.
AND ELECTRIC COMPANY FOR THE TWO-YEAR)	2003-00236
BILLING PERIOD ENDING APRIL 30, 2003)	

O R D E R

On July 31, 2003, the Commission initiated a 2-year review of Louisville Gas and Electric Company's ("LG&E") environmental surcharge as billed to customers for the period of May 1, 2001 to April 30, 2003.¹ Pursuant to KRS 278.183(3), at 2-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge and, after hearing, disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

The Attorney General, by and through his Office of Rate Intervention ("AG"), and the Kentucky Industrial Utility Customers, Inc. ("KIUC") sought and were granted intervention in this proceeding. The Commission issued a procedural schedule on July 31, 2003 that provided for discovery, the filing of prepared testimony, an informal conference, and a public hearing. LG&E filed prepared direct testimony and responded to requests for information. Neither intervenor filed testimony, and all parties requested that the case be submitted for adjudication without a hearing.

¹ LG&E's surcharge is billed on a 2-month lag. Thus surcharge billings for November 2002 recover costs incurred in September 2002, and every subsequent monthly surcharge billing under review recovers costs incurred 2 months prior to billing.

BASE PERIOD SURCHARGE FACTOR AND ROLL-IN FACTOR

LG&E calculates its environmental surcharge by utilizing a base-current methodology, which requires the calculation of a base period environmental surcharge factor ("BESF"). In addition, the amount of environmental costs to be rolled into existing base rates must be allocated to the appropriate rate classes.

LG&E calculated the BESF by dividing the environmental cost roll-in amount for the 12 months ending February 28, 2003 by the total Kentucky jurisdictional revenues for the same 12 months.² Using the proposed roll-in amount of \$15,216,797, LG&E determined that the BESF was 2.67 percent.³ The Commission has reviewed this calculation and finds that 2.67 percent is accurate and reasonable and should be approved for the environmental surcharge.

LG&E has proposed to roll-in the \$15,216,797 into base rates by increasing every component of all tariffs subject to the environmental surcharge by a percentage factor of 2.6698. This factor is determined by dividing the roll-in amount by the base rate revenue for the 12-month period ending February 28, 2003. The percentage factor would be applied to all customer charges, energy charges, and demand charges included in the tariffs subject to the environmental surcharge.⁴ Based on a review of LG&E's proposed rate design and the calculation of the percentage factor, the

² The last expense month included in the surcharge review is February 2003.

³ Foxworthy Direct Testimony, Exhibit CAF-2

⁴ Response to the Commission Staff's First Data Request dated July 31, 2003, Item 9(b).

Commission finds that the rate design and the 2.6698 percent factor are reasonable and should be approved.

SURCHARGE ADJUSTMENT

LG&E determined that it had a net under-recovery of its environmental costs of \$237,651.⁵ LG&E proposed that this net under-recovery be collected from customers by increasing the total jurisdictional environmental surcharge revenue requirement by \$59,413 a month for 4 months beginning in the first full billing month following the Commission's decision in this proceeding.⁶

The Commission has reviewed and finds reasonable LG&E's calculation of a net under-recovery of \$237,651 for the last 6-month period included in the 2-year review.⁷ The Commission also finds reasonable LG&E's proposal to increase by \$59,413 the total jurisdictional environmental surcharge revenue requirement in each of the first 4 full billing months following the date of this Order.

In addition, LG&E has proposed to modify the monthly true-up calculation. Currently, LG&E multiplies the monthly environmental surcharge factor ("MESF") for a particular expense month by the retail jurisdictional revenues for the corresponding

⁵ Exhibit CAF-1.

⁶ Foxworthy Direct Testimony at 4.

⁷ The 2-year review is composed of four 6-month periods. The first three 6-month periods were examined in previous surcharge review cases. See Case No. 2002-00193, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending April 30, 2000, October 31, 2000, October 31, 2001, and April 30, 2002 and for the Two-Year Billing Period Ending April 30, 2001 and Case No. 2003-00001, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Period Ending October 31, 2002.

billing month. The proposed modification would compare actual revenue collected to the allowed revenue as determined in the second preceding calendar month. By utilizing this calculation, the over- or under-recovery identified during future 6-month and 2-year reviews should be minimized. The Commission finds LG&E's modification to the true-up mechanism to be reasonable and should be approved. The Commission also notes a similar modification has been approved for the Kentucky Utilities Company's environmental surcharge.⁸

RATE OF RETURN

1995 Environmental Compliance Plan ("1995 Plan")

In Case No. 2000-00386,⁹ the Commission determined that LG&E's rate of return on its 1995 Plan would continue to be based on the weighted average cost of its pollution control debt, but reset the rate of return to reflect debt cost information as of December 31, 2000. During subsequent 6-month surcharge reviews, the 1995 Plan would be trued-up to reflect changes during that period in the weighted average cost of pollution control debt, with the over- or under-recovery of the environmental surcharge adjusted accordingly.¹⁰

⁸ Case No. 2003-00068, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 2001, July 31, 2001, January 31, 2002, and January 31, 2003 and for the Two-Year Billing Periods Ending July 31, 2000 and July 31, 2002.

⁹ Case No. 2000-00386, The Application of Louisville Gas and Electric Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff; final Order dated April 18, 2001; rehearing Orders dated May 14, 2001 and August 30, 2001.

¹⁰ Case No. 2000-00386, April 18, 2001 Order at 19-20.

LG&E included the true-up adjustment associated with its 1995 Plan as part of its determination of the cumulative over-recovery of the environmental surcharge.¹¹ LG&E proposed to reset the rate of return for its 1995 Plan at 3.32 percent.¹² Further, LG&E recommends resetting the rate of return for the 1995 Plan as part of each 6-month review in order to minimize the over- or under-recovery by the environmental surcharge.¹³

The Commission has reviewed LG&E's calculations of its 1995 Plan rate of return and finds them to be reasonable and consistent with the Commission's decisions in Case No. 2000-00386. Therefore, for the 1995 Plan, LG&E should use the rate of return of 3.32 percent in all monthly environmental surcharge filings subsequent to the date of this Order. The Commission also finds it reasonable to accept LG&E's proposal to reset the rate of return for the 1995 Plan as part of subsequent 6-month review.

Post-1995 Environmental Compliance Plans ("Post-1995 Plans")¹⁴

The rate of return for the Post-1995 Plans is based on the overall rate of return on capital, grossed-up for taxes. During subsequent 6-month surcharge reviews, the overall rate of return on the Post-1995 Plans is trued-up to reflect changes during that period in the cost of debt, accounts receivable financing, preferred stock, and changes

¹¹ Response to the Commission Staff's First Data Request dated July 31, 2003, Item 1.

¹² The 3.32 percent reflects the weighted average cost of pollution control debt as of April 30, 2003. The last billing month included in the surcharge review is April 2003.

¹³ Response to the Commission Staff's Second Data Request dated September 18, 2003, Item 1.

¹⁴ The Post-1995 Plans refer to the 2001 Environmental Compliance Plan and the 2003 Environmental Compliance Plan.

in LG&E's electric capital structure, with the over- or under-recovery of the environmental surcharge adjusted accordingly. Also during subsequent 6-month surcharge reviews, the cost of debt, accounts receivable financing, and preferred stock is reviewed and reset.

LG&E included the true-up adjustment associated with its Post-1995 Plans as part of its determination of the under-recovery of the environmental surcharge.¹⁵ LG&E calculated that as of April 30, 2003 its overall rate of return was 7.09 percent.¹⁶

The Commission has reviewed LG&E's calculations of its overall rate of return, as of April 30, 2003, and finds them to be reasonable and consistent with the Commission's decisions in Case Nos. 2000-00386 and 2002-00147.¹⁷ Therefore, for the Post-1995 Plans, LG&E should use the overall rate of return of 7.09 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

TARIFF ISSUE

LG&E did not propose to amend its environmental surcharge tariff in this proceeding. However, the adoption of the base-current approach adds an additional calculation to the surcharge mechanism, the determination of MESF. MESF is

¹⁵ Response to the Commission Staff's First Data Request dated July 31, 2003, Item 2.

¹⁶ Response to the Commission Staff's First Data Request dated July 31, 2003, Item 17(d). The overall rate of return, grossed-up for taxes, is 10.92 percent. This overall rate of return includes an 11.50 percent rate of return on common equity and a gross-up factor of 40.3625 percent.

¹⁷ Case No. 2002-00147, The Application of Louisville Gas and Electric Company for Approval of Its 2002 Compliance Plan for Recovery by Environmental Surcharge, final Order dated February 22, 2003.

calculated by subtracting the base period surcharge factor from the current period surcharge factor and is expressed by the following formula:

$$\text{MESF} = \text{CESF} - \text{BESF}$$

CESF is the Current Period Environmental Surcharge Factor. The remaining formulas and calculations currently used by LG&E to determine its monthly environmental surcharge remain unchanged.

The Commission finds that LG&E should amend its environmental surcharge tariff to reflect the adoption of the base-current approach and the addition of the MESF calculation. The Commission also finds that LG&E should file revisions for all tariffs impacted by the roll-in of the environmental surcharge revenue requirement approved in this Order.

IT IS THEREFORE ORDERED that:

1. The jurisdictional environmental surcharge revenue requirement of \$15,216,797 for the last 12 months of the 2-year period as billed from May 1, 2001 to April 30, 2003 shall be incorporated into LG&E's existing base rates.
2. LG&E's proposal to roll-in \$15,216,797 into existing base rates using a percentage factor of 2.6698 percent is approved.
3. Within 20 days of the date of this Order, LG&E shall file its revised tariff sheets reflecting the base-current modification to the environmental surcharge tariff and the application of the roll-in percentage factor to all rate schedules impacted by the environmental surcharge roll-in.

4. The revised tariff sheets reflecting the application of the roll-in percentage factor shall be effective for service rendered on and after the first billing cycle of the month following the date of this Order.

5. The BESF for the environmental surcharge shall be 2.67 percent.

6. LG&E shall collect \$59,413 from the total jurisdictional environmental surcharge revenue requirement determined in each of the first 4 full billing months following the date of this Order, as discussed herein.

7. For all monthly environmental surcharge filings subsequent to the date of this Order, LG&E shall use a rate of return of 3.32 percent for its 1995 Plan rate base and a rate of return of 7.09 percent for its Post-1995 Plan rate base. The Post-1995 Plan rate of return shall be grossed-up for taxes, as described in this Order.

8. The rate of return for the 1995 Plan shall be reset during subsequent 6-month reviews.

Done at Frankfort, Kentucky, this 11th day of December, 2003.

ATTEST:


Executive Director